BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC DIVISION OF CITIZENS COMMUNICATIONS COMPANY TO CHANGE THE CURRENT PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE RATE, TO ESTABLISH A NEW PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE BANK, AND TO REQUEST APPROVED GUIDELINES FOR THE RECOVERY OF COSTS INCURRED IN CONNECTION WITH ENERGY RISK MANAGEMENT INITIATIVES.	Docket No.: E-01032C-00-0751
IN THE MATTER OF THE APPLICATION OF CITIZENS COMMUNICATIONS COMPANY, ARIZONA GAS DIVISION, FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO PROVIDE SUCH RATE OF RETURN.	Docket No.: G-01032C-02-0598
IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS COMMUNICATIONS COMPANY AND UNISOURCE ENERGY CORPORATION FOR THE APPROVAL OF THE SALE OF CERTAIN ELECTRIC UTILITY AND GAS UTILITY ASSETS IN ARIZONA, THE TRANSFER OF CERTAIN CERTIFICATES OF CONVENIENCE AND NECESSITY FROM CITIZENS COMMUNICATIONS COMPANY TO UNISOURCE ENERGY CORPORATION, THE APPROVAL OF THE FINANCING FOR THE TRANSACTIONS AND OTHER RELATED MATTERS.	Docket No.: E-01933A-02-0914 Docket No.: E-01032C-02-0914 Docket No.: G-01032A-02-0914 **INTERVENOR MOHAVE COUNTY'S CLOSING BRIEF**

The hearing on this Consolidated Docket took place on May 1, 2 and 5. The subject of the hearing was the Settlement Agreement which consolidated issues in five separate dockets involving the Electric rate, Gas rate, and Joint Application seeking approval of CC&N transfer and financing for the sale by Citizens to UniSource.

We make three observations in this Brief, directed to the Electric rate docket, in order to underscore what appears crystal clear and non-disputed by record or testimony—That until UniSource and Tucson Electric Power stepped into picture in November of 2002, 70,000 plus ratepayers in Santa Cruz and Mohave Counties faced this rate picture from their regulated utility provider: Citizens had not offered this Commission or its 70,000 ratepayers any solution to the $82 plus million in power purchase costs, i.e., the PPFAC pass through to ratepayers under its 1995 Agreement with APS, other than (1) a "new" contract with APS, which has so far accumulated an additional $50 plus million in additional PPFAC pass-through power purchase costs to the ratepayer, and (2) a request to the Commission to allow it collect from the ratepayers the full $82 million and the full (now $50 million) in increased PPFAC charges under the new agreement, <u>and</u> continue passing the new agreement's PPFAC increases (resulting in an approximate 22% residential rate increase) through to the ratepayer. UniSource has eliminated that picture, leaving only what it must legally honor under its acquisition of Citizens: Citizens' new FERC-approved, market-based, fixed-rate contract's impact on the PPFAC component to the approved rate, i.e., a 22% increase to residential ratepayers, which, contract, it has told the Commission it will attempt to renegotiate, sharing any savings with the ratepayer.

<u>FIRST:</u> In the Electric rate docket, Docket No. E-01032C-00-0751, at no time did Citizens in its Original Application for PPFAC adjustment filed September 28, 2000, or its Amended Application filed September,19, 2001, ever offer to this Commission as a possible solution to what is now a $130 plus million PPFAC adjustment request, that it would forego collecting from Citizens' ratepayers in Mohave and Santa Cruz County those excess power costs which it incurred under power purchase contracts *which Citizens knowingly entered into with APS instead of investing in sufficient generation assets of its own to cover its ratepayers' needs.* As the Staff Report, at page 41 succinctly demonstrates: the $130 plus million adjustment request would result in a PPFAC pass through rate increase to residential customers in the range of 27%, in the best of circumstances, to 39%, in the worst of circumstances.

SECOND: Under neither its Original or Amended Application in Docket No. E-01032C-00-0751 did Citizens ever offer to this Commission as a meaningful solution to a repeat of the $ 130 plus million PPFAC adjustment request, that it, *Citizens, its management and stockholders, bearing their own corporate risk and not relying on "maybe" ventures with APS or merchant generators* , would commit to *Citizens* (which holds the exclusive right, with its accompanying *duty,* to serve the 70,000 ratepayers in Mohave and Santa Cruz Counties) investing in sufficient native load generation to avoid risk to its ratepayers. The risk avoided is that of the very well understood situation where *any* wholesale supplier, (APS in this case), will clearly, reasonably, and rationally serve its native load ratepayers first in a short supply-high demand market, and seek market purchased power to supply its contracted utilities. (Argument and dispute over specific contract terms aside in this Docket, it is *irrational* to believe that any generation-owning power supplier would ever *knowingly* enter into any type of agreement with a retail utility where it would agree to saddle its native load ratepayers---who, after all had paid for their own native load generation assets in the first place---with any portion of high-priced market purchased power, to "protect" its non-generation owning, contracted utility's ratepayers in a short-supply, high-demand situation. That type of agreement, generation-owning utility's ratepayers and its shareholders would quite rightfully argue, would result in an unjust and unreasonable rate to them, and the wholesaler would quite persuasively argue that such was never intended, and the disputed contract terms should be interpreted in that light…(Citizens' own touted $43 million dollars savings, as described below, under the 1995 APS contract does not bode well for an interpretation of that contract that there was no downside risk to such an agreement, i.e., the $82 million increase in power costs.)

The circumstance of having to pay APS $130 plus million in excess PPFAC power costs, is solely the responsibility and burden of Citizens, its management, and its owners. When market conditions were good, this served Citizens well. In its Original Application it tells us how well: On page 2, Citizens tells us---

> "As stated, the AED is a generation-dependent utility. For nearly thirty years, with a few minor exceptions, its sole power source has been a full requirements contract with APS. Power supply expenses have been recovered by the AED through the power cost component of basic service rates and the operation of the Purchased Power and Fuel Adjustment Clause….Under the traditional regulatory paradigm in Arizona, this arrangement has served the AED and its customers well."---

and on page 26, Citizens tells us---

> "…since the signing of the current system-incremental-cost contract in 1995 through the beginning of this summer, Citizens saved approximately $43 million in power supply costs, as compared with pricing under an average system cost contract with APS."

Or to put this in a different, but relevant, context, Citizens is saying that it avoided the hard corporate and shareholder decisions *and risk* inherent in investing in sufficient generation assets to protect its customers during the transition from a cost-based market to a market-based market, and relied on APS which had made those hard "shareholder" decisions to reliably supply power to its ratepayers, and saved $43 million dollars under the 1995 contract. (The contract prior to this apparently would not have saved Citizens $43 million.) Surely, these savings to Citizens under the 1995 contract had to have a contractual counterbalance for APS under the 1995 contract, or changing from the prior contract to the 1995 contract would verge on irrational behavior or gross imprudence by APS, e.g., under the new contract you, Citizens, save $43 million and we, APS, lose recovery from you of $43 million when times are good; but, when times are bad, you, Citizens, save $82 million and we, APS, lose $82 million recovery from you. Yet, that is the essence of Citizens suggested interpretation of the 1995 contract with APS in comparison with its predecessor.

A contractual counterbalance to Citizens' savings of $43 million, of course, does exist: it is the $82 plus million in PPFAC under the 1995 contract which Citizens had to pay when the market was not good. The 1995 contract would be understood as high-risk contract for Citizens—but for the PPFAC pass through component to the basic rate.

In short, the owners and shareholders of Citizens decided to avoid the risk to the company and shareholders of investing in generation assets, by passing power-generation risks through to ratepayers in the form of power purchase agreements which had a PPFAC adjustor, i.e., a direct pass through to ratepayers. When times were good, this was $43 million good—and the ratepayers shared in this in accordance with the PPFAC's $2.6 million cap on PPFAC reduction. When times were bad, this was $82 million bad—and the ratepayers would have shared in this in accordance with the PPFAC's $2.6 million cap on increases--except that Citizens sought to eliminate any impact on its company and stockholders by requesting this Commission to pass through to the ratepayer all of its excess power costs, e.g., which amount to approximately $82 million by June of 2001.

The wisdom and prudence of Citizen's power purchasing strategy is arguably now, and may well forever be, inconclusively debatable against the backdrop of the Western Bulk Power market dislocated by wildly oscillating market forces brought on by a unique combination of extreme weather and hydroelectric conditions coupled with the flawed attempt at deregulation in California which various market traders took advantage of. See generally, FERC Docket PA02-000, Final Determination, of March 26, 2003.

THIRD:

It was not until the filing of the Joint Application by UniSource, TEP and Citizens in November of 2002, and its companion Settlement Agreement filed April 1, 2003, that the Commission sees any attempt by Citizens to modify its ongoing refusal to present this Commission with a solution to a problem of its own making, other than that the ratepayer had to pay for Citizens' engaging in high risk power contracts instead of building or acquiring its own generation resources to reliably supply its ratepayers. And it appears clear that Citizens would *still* not be offering this Commission any solution other than make the ratepayers pay $130 plus million for its corporate decision to enter into a high risk contract instead of investing in generation resources, *except* for the fact that UniSource has entered the picture to acquire its Electric Division assets, and has proposed a solution which was actually Citizens' responsibility to propose to this Commission—forego passing $82 million excess power costs from Citizens' old power purchasing practices.

UniSource has gone even further, however, and has told the Commission that it wishes to forego $50 plus million from Citizens' new power purchasing practices. The aftermath of Citizens' corporate purchasing practices is that UniSource is stuck with Citizens' current purchasing power contract as a liability, in the real sense of the term—Citizens' new contract with APS is binding on UniSource and will result in an unavoidable 22% increase to the ratepayer unless UniSource can successfully renegotiate that problem with the supplier.

CONCLUSION:

UniSource and TEP have not wavered in the Agreement in any respect with regard to any of the core relief for electric ratepayers which they told the Commission in the Joint Application would be an elimination of *all* of the excess power purchase pass through (approximately $138 million by July 28, 2003) to ratepayers under the PPFAC component of the approved utility rate; leaving only the market-rate-based, fixed-rate contract which Citizens entered into with APS as impacting ratepayers, i.e., requiring a PPFAC base rate adjustment to $0.07019 per kWh . Page 3, Joint Application.

Since UniSource is legally responsible for Citizens' liabilities (purchase contracts) when it acquires Citizens, UniSource is required to honor the contract which Citizens entered into with APS. By any reasonable standard, UniSource's solution to the $138 million excess purchase power costs problem which Citizens caused under Citizens' corporate policies, is beneficial to the ratepayers---even though it still leaves them with the lingering legacy of Citizens' "strategy" of not risking its shareholder's money in investing in generation, but, rather insulating its shareholders from any risk at all, by engaging in power-purchase contracts with power suppliers, under a PPFAC pass through component to its basic rate, i.e., the "new agreement" with its built in 22% increase in residential rates.

Whether "honoring" the new contract is palatable to UniSource, or whether UniSource would have entered into a different contract, or any contract at all, or would have embarked on constructing generation facilities to supply the ratepayers in Santa Cruz and Mohave Counties, are not particularly relevant concerns for this proceedings. There is no serious dispute that the new agreement is a FERC-approved, fixed-rate, long-term, market-based-rate agreement, and APS has every right to expect Citizens or its successor in interest, UniSource in this case, to honor the contract in accordance with its terms. The best choice of electricity provider is simple from this standpoint: UniSource. The fact that UniSource comes bundled with a legacy contract from Citizens is a simple fact of legal jurisprudence: it acquires Citizens' assets and liabilities when it purchases the company.

The larger question of whether 70,000 ratepayers in two Counties in Arizona should be left with a legacy of being at the mercy of electricity generators and wholesalers under "market-based-rate" contracts because of Citizens' corporate policy of not constructing or acquiring generation resources to serve its ratepayers during the 30 years of its tenure as the holder of a state-approved franchise, cannot be answered under these proceedings.

To view that circumstance from a different perspective is to see that there is an unintended consequence of the PPFAC mechanism in the form which Citizens presented it to this Commission in its Original Application for relief: under Citizens' 1995 contract with APS together with its June 2001 replacement, the PPFAC mechanism insulates Citizens' stockholders and management in their decision to avoid the risk of investing in generation resources, by allowing a direct pass through of whatever power costs Citizens paid to the ratepayer. Citizens' original application makes much of the fact that the PPFAC is a Commission-approved mechanism. Pages 4 through 9, Original Application. From that, however, it does not follow, that *any* power costs may be passed through. Indeed, the fact of the matter is that the Commission capped the PPFAC at $2.6 million dollars---not at $82 million, or whatever Citizens ended up paying---which alone indicates that the PPFAC was never intended to be a stockholder insulation mechanism.

UniSource has eliminated to the extent it could under the circumstances this unintended consequence by simply eliminating the $138 million in past charges. It cannot eliminate the

PPFAC component of the rate, or the "FERC-approved" agreement which now constitutes that component, without conducting a full rate hearing. The hearing before this Commission simply deals with a PPFAC adjustment, which is a legacy of Citizens' corporate strategy in avoiding the risk and costs of investing in generation resources, by simply buying power and passing those costs on to the ratepayers. This was not UniSource's strategy, it is simply a strategy which it inherits when it buys Citizens.

REQUEST:

It is respectfully requested that the Commission approve the transfer of the Certificate of Convenience and Necessity from Citizens to UniSource under such terms and conditions as the Commission determines result in a just and reasonable rates in the electric and gas rate dockets.

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Filed May 14, 2003, with:

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